A COMPARISON OF ADEQUATE PUBLIC FACILITIES ORDINANCES

WITH

OTHER INFRASTRUCTURE CONCURRENCY TECHNIQUES

IN MUNICIPAL ANNEXATION

By

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Background

The Board of County Commissioners of Frederick County adopted an ordinance in 1991 for the purpose of ensuring that residential development in Frederick County did not outpace the County's public infrastructure. Frederick County's APFO was updated in 1998. During the past few decades, Frederick County has experienced a period of extraordinary residential growth and development. At an earlier time in the County's history, it was a responsibility of the government to ensure the development of roads, schools and utilities to accommodate growth, regardless of the pace at which development proceeded.

Statutory authority for the enactment of APFO regulation in non-charter counties and municipalities is found in § 10.01 in Article 66B of the Maryland Code.

The APFO concept is also embodied in Maryland's smart growth visions, which provide, in pertinent part:

> "(a) To encourage the preservation of natural resources or the provision of affordable housing and to facilitate orderly development and growth, a local jurisdiction that exercises authority granted by this article may enact, and is encouraged to enact, ordinances or laws providing for or requiring:
>
> > (1) The planning, staging, or provision of adequate public facilities and affordable housing;..." Md. Ann. Code, art. 66B, § 10.01

The beneficial result of APFO regulation is the achievement of concurrency between development and availability of public infrastructure. The unintended consequence of such regulation is the deferral of construction of needed housing. APFO regulation does not lessen the demand for housing. Such regulation necessarily impacts the factors of supply and demand in the housing market, with unintended consequences on the cost of purchasing a new home. When the government constricts the housing supply by regulation, the decrease in supply results in an increase in market price. This increase operates at several levels.

First, as other land use regulations constrict the areas of the county in which residential subdivision is permitted, the developers, seeking an inventory of lots will bargain competitively with the owners of undeveloped tracts zoned for development. As the supply of suitably zoned parcels is defined by government regulation rather than by the market, governmental policies not only determine where development may lawfully occur, but at the same time, constrict the supply of available parcels within designated growth areas, excluding other parcels from the market. The inequities resulting from such market controls are well-known to elected officials. The agricultural community is particularly hard hit, with economic gain conferred upon some farmers and downzoning on others. While it may be debatable in the short term whether the effect on land values resulting from aggressive development constraints lowers market values generally, it cannot be denied that it severely affects properties which are otherwise suitably located and configured for development, and which are only prevented from such use by regulation. Those properties most severely impacted are those whose highest and best use was for residential development prior to the constraining regulation.

As developers and developer/builders survey the undeveloped lands upon which development is permitted, they inevitably compete for the few available tracts within designated growth areas. As adjacent jurisdictions regulate growth, imposing strict growth controls and even resorting to moratoria, more developers enter the market from outside the region. The demand increases as the supply of development land decreases. Owners are visited by developers, speculators and brokers with increasing frequency. Sensing the localized benefit of such regulations, property owners respond to these favorable market conditions and become motivated to sell. The early sales at a higher price tier provide comparable sales which support appraisal of other land similarly situated. Developers and investors compete for the few available parcels, while the fortunate owners hold out for even higher offers.

The prices established in the market described above compel the purchasing developer/builder to seek higher density levels in order that the development of the parcel will generate sufficient sales revenues to recover the higher cost of purchasing the land. Maryland's "Smart Growth" initiatives encourage the higher density of development, promoting compactness of development and its positive impact upon infrastructure investment. Contract purchasers of land once considered appropriate for single-family residential development will seek and be granted regulatory approval for higher residential development densities required to defray increasing land acquisition costs.

These lands, once priced to accommodate low-density development at a profit, are often located adjacent to existing single-family residential development. The juxtaposition of these incompatible densities inevitably results in land use conflict.

The original and fundamental purpose of zoning regulation is the elimination of potential conflicts resulting from incompatibility of adjacent land uses. Thus, it may be said that, when "Smart Growth" and the economics of the market combine in a rural setting, the consequences of "Smart Growth" policies will yield development patterns which are at odds with the fundamental objective of land use regulation.

Not all geographical areas of the county are in play at once. The market tends to focus on lands where development is permitted as a matter of right, by virtue of available utility services. The pattern of development often proceeds outward from the area in which development has previously occurred. Communities tend to grow outward in concentric patterns, with the age of the housing stock resembling the rings of a cross-cut tree trunk. Where densities are unaffected by artificial factors affecting supply or demand, each succeeding outward ring will be predictably compatible with the existing adjacent development, providing a continuum of compatible neighborhoods. The need for affordable housing is often fulfilled by the aging housing stock nearer to the historic core of the community, or by urban renewal and historic restoration, providing municipal government with a measure of relief from the slow deterioration of the *ad valorem* tax base of our aging urban communities.

Second, adding to these market forces, local government has placed an increasing burden upon developers, which is inevitably passed along to home purchasers. Impact fees, excise taxes, local transfer taxes and other revenue raising measures become part of the financial burden of acquiring a home. These added costs are more easily tolerated in a mortgage market in which interest rates have remained favorable. Nevertheless, as housing costs and interest rates rise, a larger percentage of potential first time homebuyers will be excluded from the market, and housing affordability will become a predominant consideration of future land use policy.

It may be suggested that housing costs will escalate regardless of land use policies and their impact on supply and demand. However, with stability in cost of building materials and low interest rates, the economic components which would otherwise support such a suggested progression are not readily discernible.

Brute force application of "Smart Growth" policies in rural counties has a counterproductive impact upon housing affordability and land use compatibility. Instead of regulating land use according to traditional "Smart Growth" principles, it should be the objective of government to find ways to direct investment without impacting the market. Land use regulation which is restrictive merely pushes market demand to someone else's community, without solving the problem. For example, the imposition of a temporary development moratorium has a profound impact upon the market value of development land exempted from the moratorium. Where market demand for new housing is enduring, a moratorium does not reduce demand; it merely shifts the demand geographically to land not subject to the prohibition of the moratorium. Some owners benefit, while others are penalized.

Development Driven Annexation

In Maryland, when county land development policies and exactions become more burdensome, developers are attracted to municipalities. Maryland municipal law provides flexible and autonomous home rule, with exclusivity of land use regulation.

Traditional motivating factors in development-driven annexations have included access to municipal utilities and higher development densities. Relief from prohibitive county land use regulations has become a new incentive for developers wishing to purchase and develop land contiguous to a municipal boundary. Developers perceive that municipal annexation may facilitate development which is lower in cost, more timely and responsive. Municipalities wishing to attract residential development and annexation predictably respond with accommodating land use policies and streamlined subdivision and development procedures.

Before "Smart Growth" became the watchword, municipalities could often succeed in attracting development driven annexation through density alone. However, with legislative reform in 1997, the General Assembly restricted state capital investment to designated priority funding areas, creating a minimum residential density threshold of 3.5 dwelling units per acre. County land use policies which had traditionally been conservative in allowing such densities outside municipal boundaries responded by encouraging development around existing municipalities through zoning classifications allowing priority funding area compliant densities. This leveled the density playing field, removing density advantages from municipal government as one of the traditional annexation incentives. Annexation interest declined.

Those municipalities wishing to grow through annexation, but lacking utilities, were left with nothing to offer the developer/builder aside from the marketing disincentive of municipal property taxation of the completed homes.

When the county government enacted adequate public facilities regulation, a new incentive for annexation was born: escape from the restrictive APFO. For no other reason, developers began to approach municipal government, perceiving that municipal government may provide a more permissive setting for development. In Frederick County, the pivotal debate has, in recent years, focused on school adequacy concerns.

In *Steel v. Cape,* 111 Md. App. 1 (1996) Judge Cathell, writing for the Court of Special Appeals of Maryland, observed that, while the provision of public facilities is a legitimate concern of the County, the burden of providing adequate schools is "disproportionately placed" upon the developer; and that "[t]he County at-large must bear the burden of providing adequate schools."

In 1997, the General Assembly confirmed the authority of county government to impose development impact fees within municipalities for the purpose of financing school construction. Md. Ann. Code, art. 23A, §8C The County is provided with the opportunity to fund capital projects in public education regardless of annexation. In contrast, municipal government has no authority to direct or phase matters of public school funding or construction.

As State funding for education declines, County government is forced to make up the difference. The political ebb and flow of public education funding is not predictable with accuracy. Even when funding is assured, the process of site acquisition, design and construction can take several years. Educational facilities planning must be up to the challenge to ensure that school facilities keep pace with population needs. Where school facilities are not adequately planned and implemented, and fall behind population growth, the county government has few alternatives available to avoid overcrowded classrooms. Among those alternatives is the restriction of new residential development.

As the county restricts development within the county in response to predictable school overcrowding, developers increasingly turn to municipalities, which may annex development lands and allow development unconstrained by no growth county policies.

The Municipal Annexation Dilemma

From the municipality's perspective, the opportunity to annex presents a decision with long term implications. If the property is annexed, the municipality retains its ability to grow. In addition, the annexation creates new municipal boundaries with newly contiguous lands adjacent to the annexed parcel. In contrast, a decision by the municipality not to annex seals the municipality's fate. If the contiguous development property is developed, and homes are sold to registered voters, it is unlikely that the community of voting residents will ever seek or consent to be annexed, since annexation would result in the imposition of municipal taxes. Every generation of municipal elected officials holds the power to freeze the corporate boundaries of the town by inaction. The consequences of a failure to annex are permanent. Municipalities which have not reached an optimum scale can be surrounded by new growth without annexation, leaving no annexation path.

To add to the difficulty, complete encirclement of the municipality is not required to foreclose future annexation. Because state law prohibits the creation of enclaves in successive annexations, each non-annexed contiguous development becomes a potential enclave, and a potentially permanent disruption of municipal annexation policy. Even where county government has designated a region for municipal growth, each lost opportunity to annex impairs the fulfillment of such county land use policy. County designation of a municipal growth area alone cannot guarantee that annexation will occur. The success of an annexation policy requires the presence of incentives for annexation. One of those incentives is the differentiation of how development is regulated across municipal-county boundaries. The adoption of a municipal adequate public facilities ordinance would eliminate the differentiating incentive which has been the impetus of recent interest in development driven annexation in the portion of Frederick County contiguous to the Town of New Market.

Under Maryland law, annexation requires contiguity. The parcel sought to be annexed must be contiguous and adjoining the existing municipal boundary. Md. Ann. Code, art. 23A, § 19 Thus, only a finite number of parcels may be considered for annexation at any one time. It is development interest in specific contiguous properties which creates the opportunity for annexation. The pace at which annexation may proceed is constrained by the requirement of contiguity.

The Permanent Adverse Consequence of Adoption of a Municipal APFO

Even though the area available for annexation is constrained by the requirement of contiguity, such annexation, even on such a small scale, presents concerns to county government, since the development which is facilitated by annexation may have been prohibited or at least delayed under county land use regulation. The quick response of county government is the demand for adoption of parallel APFO regulation within the municipality.

Any interaction between municipal and county governments may present an opportunity to demand ill-considered municipal APFO adoption. When New Market was asked by the County government to allow a county water main to be constructed through a portion of the Town's annexed lands, the respective governments entered into negotiations which eventually led to a cooperative utility agreement signed in April, 2003. Even in matters of obvious mutual benefit, the County used the opportunity to pressure the Town government in the direction of APFO adoption.

Without an understanding of the adverse consequences inherent in an APFO upon the ability of the municipality to grow in future generations, the request would superficially appear to be reasonable. But with a more thorough understanding of the consequences of such a policy upon developer interest in annexation, the request may properly be seen as a request upon the Town government to irresponsibly seal its own fate. Any municipality desiring to enlarge its territorial limits would be ill-advised to make such an irresponsible choice, where other alternatives to achieve concurrency exist. The acceptance of such a policy would violate the public trust impressed upon elected municipal officials. Any elected municipal official allowing such an outcome would merit condemnation for generations to come.

The Questionable Validity of APFO Waiver Payments

Like the development moratorium, the APFO, as a growth management technique, is brutally effective. However, it is less useful as a concurrency technique, since the ability to require developer funding through the exercise of police power of land use regulation has not been judicially recognized in this State. To the contrary, dicta in the 2002 decision in *Halle Development Co. v. Anne Arundel County,* provides insight into the potential invalidity of such exactions. The case concerned the propriety of allowing developers to purchase land use privileges by making voluntary APFO waiver payments.

The Court, in *Halle,* did not reach the issue of APFO waiver payment validity, since it found that the developer having voluntarily made the waiver payments, gave up its judicial remedy. The Court noted that while there exists express statutory authority to impose development impact fees, no similar statutory authority for APFO waiver payments is found. The Court, while not reaching the issue, intimated the probable result of such an inquiry:

> "We do not address the legality of respondent's Adequacy of Public Facilities Ordinance in this case." * * * "As we have indicated, we do not expressly reach

> whether the fees in this case were 'taxes,' although they resemble taxes." *Halle Development Corp. v. Anne Arundel County,* 371 Md. 312, *n.* 11, 15 (2002)

The Court intimated, however, that the issue of the validity of APFO waiver fees and the agreements in which they are created,

> "...may be addressed when more adequately preserved and presented in a future case." *Halle Development Corp. v. Anne Arundel County, supra*, *n.* 4

Part of the dilemma presented by the concept of APFO waiver payments is the impropriety of allowing a developer to *buy* land use accommodations. While others who are unwilling to pay must await the public financing of off-site infrastructure, developers willing to contribute are exempted. Such a practice offends traditional concepts of fairness and orderly regional land use planning. It may be expected that APFO waiver payments will be judicially scrutinized as impermissible contract zoning.

Preferable Municipal Alternatives to a Parallel APFO

As the proposed *New Market Region Plan* observes, there are "several regulatory means which may act as staging mechanisms to control the timing of planned development in an effort to coordinate the development with the provision of infrastructure." *New Market Region Plan* (Staff Draft, November, 2003) An adequate public facilities ordinance is one of several available techniques which may be employed to achieve concurrency.

All of the lands considered for development in the County are already within the county's boundaries. In contrast, properties considered for development by annexation must first be annexed. Annexation presents an opportunity for the creation of a contractual relationship between the municipal government and the developer.

Achieving concurrency by voluntary contract is not constrained by the limitations imposed when government controls land use through regulatory exercise of land use police powers. Achievement of concurrency by contract has significant advantages over achievement of concurrency by regulation. Thus, municipal government has tools in annexation which may be more effective in achieving concurrency than the regulatory tools which may be applied by county government.

Annexation agreements which are in accordance with public policy are judicially enforceable in this State. *Mayor and Council of Rockville v. Rylyns Enterprises, Inc.,* 372 Md. 514 *n.*35 (2001) Moreover, many of the matters which may be found in annexation agreements may be embodied in development rights and responsibilities agreements authorized by the General Assembly in 1995. See: Md. Ann. Code, art. 66B, § 13.01, *et seq.* The statute provides express authority for agreements relating to the "construction or financing of public facilities." Md. Ann. Code, art. 66B, § 13.01 (f)(1)(*x*)(4) Such agreements are binding upon the developer, and its successors in interest. Md. Ann. Code, art. 66B, § 13.01 (k)(2)

The legislative authorization of agreements for the funding of development-related public facilities in the context of municipal annexation agreements provides an alternative mechanism for achieving concurrency and providing developer funded off-site infrastructure. Given the choice of mechanisms in annexation, contractual undertakings offer significant advantages of judicial acceptance and flexibility over APFO alternatives. In the context of annexation, municipal government may achieve concurrency more effectively by contract than by an APFO.

The use of contract mechanisms for the staging of development and infrastructure has the advantage of preserving annexation incentives while ensuring that annexation-based development does not outpace infrastructure.

New Market has had a history of successful implementation of development constraints through the use of annexation agreements. In the past decade alone, every annexation approved by the Town government has included provisions for phasing of residential construction in relation to the scheduling of school facility construction. New Market is already accomplishing by agreement the concurrency which would be gained through use of APFO techniques.

There is no potential development property within the municipal limits of New Market which is not subject to an annexation agreement. In contrast to development in the county, no land may be developed in the Town until annexation occurs.

Thus, in every case, development must be preceded by annexation, which presents an opportunity to phase development by contract rather than by regulation. This distinction has empowered New Market to go far beyond the traditional land use authority exercisable by ordinance. Annexation agreements are in the nature of contractual restrictive covenants, and may provide for architectural controls and other beneficial arrangements which may not be achieved through the regulatory police power of land use controls.

It is in New Market's interest to continue the use of annexation agreements in municipal annexation and development. The addition of a tier of APFO regulation would not only be superfluous; it would be counter-productive.

If New Market were to adopt a municipal adequate public facilities ordinance, the authority of the Town government to enter into contractual agreements providing for monetary contributions in exchange for an APFO waiver, rather than as a component of a development rights and responsibilities agreement, would subject the arrangement to the precise judicial challenge intimated by the Court of Appeals of Maryland in *Halle, supra.*

Even if New Market were politically disinclined to provide for the responsible phasing of residential development through annexation agreements, the county has regulatory control of development through the allocation of utility tap fees. As the draft *New Market Region Plan* observes, the April 2003 Water Service Area Agreement must be amended for additional annexation and development to occur.

A responsible analysis of the issue presented in this study leads to the sound and incontrovertible conclusion that the adoption of a municipal APFO is neither appropriate nor necessary in implementing a policy of infrastructure concurrency in cooperation with county government.